Lowering Your Revenue Restatement Risk

The Revenue Compliant Enterprise: An Entirely New Way To Manage Revenue Recognition

By Robert O'Connor

Revenue recognition is consistently among the leading causes of financial restatements. That's because revenue recognition problems are typically not due to flagrant disregard for the rules. Most revenue related restatements result from misinterpretation or misapplication of appropriate guidelines, or poor enforcement of revenue policies throughout the corporate reporting structure.

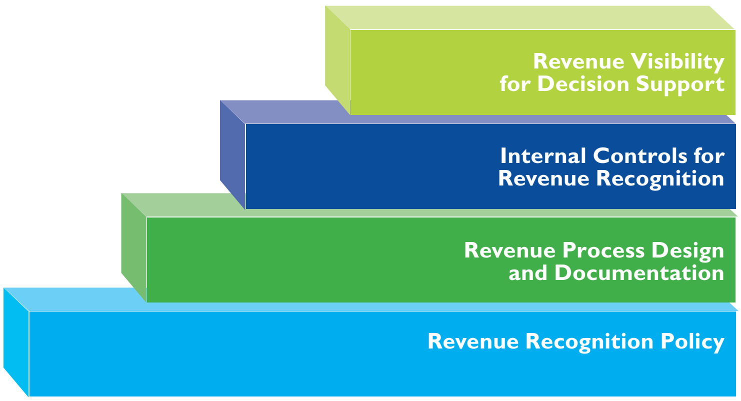
Ensuring consistent and accurate revenue reporting is complicated. The breadth of data, number of accounting guidelines, and contractual details involved are staggering. Decisions frequently require financial staffers to make judgments based on complex accounting guidelines relying on information which is typically scattered across disconnected systems and spreadsheets or even buried in e-mails and individual files.

Typical financial and ERP systems have focused on the order to cash process and have not been designed to mirror a company's revenue policy nor manage the unique requirements of the revenue recognition process. According to research from RevenueRecognition.com and IDC, 92% of public companies use spreadsheets to pull their revenue data together for reporting. But, spreadsheets are far from the ideal approach—they prevent standardization, resist controls, and are almost impossible to monitor and audit effectively.

Companies need to take an entirely new approach towards managing their revenue recognition processes not only to lower their restatement risk, but also to improve the financial close process, speed up revenue recognition reporting, enhance revenue recognition forecasting, and allow strategic insights into their revenue streams.

The following steps are an effective way to apply a comprehensive approach to revenue management and become a "revenue compliant enterprise":

THE FOUR STEPS TO A REVENUE COMPLIANT ENTERPRISE



Turn your revenue policy into an automated, workflow-driven, integrated process.

Companies need to support complex revenue recognition processes without being tied to the operational constraints of typical ERP systems, and without slowing down the existing order to cash process. To avoid issues of incorrect and inconsistent revenue reporting, the revenue recognition policy has to be mirrored in a single operational process with all the proper controls. Correct revenue process design and respective workflow automation will ensure consistent and accurate revenue recognition across the enterprise. This will not only improve accuracy and speed, but also allow accounting personnel to spend more time on complex accounting interpretations, exceptions, and decision support.

Apply robust controls for consistent and accurate revenue recognition.

To support such a complex process, several key controls with deep accounting intelligence need to be considered:

» **REVENUE ALLOCATION**—A key area of concern is properly allocating revenue, which determines the correct amount of revenue. Both GAAP (e.g. based on EITF 00-21 and Fair Market Value) and non-GAAP (e.g. driven by internal reporting needs) allocation rules should be able to be applied to the appropriate revenue streams.

» **REVENUE SCHEDULING**—Revenue scheduling addresses the issue of properly timing and forecasting revenue. Best business practices call for revenue scheduling to be applied at the transaction level. This simplifies managing the changes that inevitably occur after the original transaction has been initiated and represents a point of detailed audit control. The major challenge faced by most companies is the sheer volume of data that needs to be created and managed.

» **REVENUE RECOGNITION**—The basis for revenue recognition can be as simple as a delivery date, a combination of multiple conditions, or it can be so complex that it requires careful interpretations by the financial staff. One major problem is providing visibility into critical events that impact revenue recognition now and in the future.

» **Revenue Accounting**—Revenue accounting is the bridge between the subsidiary ledger and the general ledger. It includes the ability to record accurate billing/receivables against the revenue schedules (e.g. multi-currency transactions as defined by FASB 52) so that the correct amount can be booked as unbilled or billed and deferred or recognized revenue.

Gain full visibility into the revenue cycle to ensure comprehensive revenue compliance.

Compliance is a holistic effort that must be consistently rigorous throughout the entire revenue cycle. To show compliance with all revenue recognition rules and document the proper internal controls and Sarbanes-Oxley requirements, the full revenue recognition process needs to be inherently transparent, documented and testable. To provide the records necessary to fully account for all revenue recognition decisions, revenue transactions must be supported with a robust audit trail. This will allow for streamlined audits and clear documentation of robust internal controls.

Monitor the business to fine tune revenue recognition.

Often, accounting staff is stretched just to produce accurate recognized and deferred revenue reports. As a result, much of the strategic value of the underlying information is lost. When revenue data is in a controlled environment, it can be transformed into meaningful information. Risks that may jeopardize forecasted revenue can be better understood and managed, such as revenue that may be delayed into the following quarter if certain conditions aren't met. Visibility is improved to the point where companies can proactively address issues that impact revenue recognition before the business is even booked, such as making changes in delivery schedules or payment terms.

It also becomes possible to develop and monitor Key Performance Indicators (KPIs) for revenue recognition on a consolidated as well as a detailed level. These could include revenue back log, aged revenue (revenue that was expected to be recognized, but was delayed,) and deferred revenue roll-over (origination of deferred revenue.) These KPIs then may be applied on a product, segment, region, or account basis to improve overall revenue performance.

Enhance strategic decisions with true revenue recognition forecasts.

True revenue forecasts actually forecast the expected recognizable revenue of your business. This will give executives an estimate on how much and in which period revenue can be expected to be reported to shareholders. Forecasted revenue typically can be broken into the following four "levels of certainty":

» Revenue from business which already has been booked and there is a high degree of certainty about the timing of the recognizable amount.

» Revenue related to future commitments, such as services. This revenue typically has a high degree of certainty associated with it, although the timing of recognition may not be well understood and may depend on critical milestones being reached.

» Revenue from repeat business such as contract renewals. Forecasting this revenue must take into account historical trends and exceptions.

» Revenue from new business contracts. This is the least certain revenue in the forecast, where both timing and revenue amounts need to be estimated.

To produce a true forecast of recognizable revenue it is critical that the revenue recognition policy and processes of pipeline business are closely related to the same accounting standards that will be used for booked business.

Beyond avoiding risk to better decision making.

The benefits of achieving the revenue compliant enterprise are wide ranging and go well beyond avoiding restatements. The availability, reliability, and usability of key business performance information improve tremendously. Compliance processes are easier to manage, lending greater confidence to executive certification and attestations. Tedious mandatory tasks such as closing the books and supporting audit processes become far more efficient allowing more time for proactive analysis. Most importantly, executives are better informed about key revenue recognition drivers, enabling them to make the right business decisions at the right time. ■

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